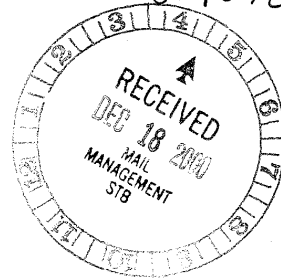


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BEFORE THE
SURFACE TRANSPORTATION BOARD

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MAJOR RAIL CONSOLIDATION PROCEDURES

UNION PACIFIC'S REPLY COMMENTS
ON PROPOSED MERGER RULES

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TABLE OF CONTENTS

	<u>Page</u>
I. DOWNSTREAM EFFECTS	7
II. SAFEGUARDING RAIL SERVICE	9
III. PRESERVING AND ENHANCING COMPETITION	12
A. Gateway Preservation	13
B. Divestitures and Trackage Rights	16
C. Intermodal Competition	17
IV. THREE-TO-TWO ISSUES	18
V. PUBLIC BENEFITS AND HARMS	19
A. Merger-Specific Benefits	19
B. Merger Harms	21
C. Penalties for Unrealized Benefits	23
D. Presumptions Regarding End-to-End Mergers	24
VI. CROSS-BORDER ISSUES	24
VII. PASSENGER SERVICE ISSUES	25
A. The Capacity Crunch	26
B. Prior Consultation	28
C. The Public Interest Standard	29
D. Respecting Commuter Service Contracts	29
E. The “Essential Services” Standard	30
F. Requests to Divert Freight Capacity for Commuter Service	32
G. Passenger-Related Oversight	33
H. Labor Protection for Transit Employees	34

VIII.	LENGTH OF PROCEEDINGS	34
IX.	CLASSIFICATION OF CARRIERS	36

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Union Pacific Railroad Company and Union Pacific Corporation (collectively, "UP") submit these comments in response to the November 17 opening comments.

INTRODUCTION

UP incorporates and adopts the Reply Comments of the American Association of Railroads ("AAR") and the National Railway Labor Conference filed today. It submits the following supplemental comments to address additional issues of particular concern to UP. We also remind the Board of several UP proposals that would address a frequent objection to the Board's proposals: several rules lack specificity.

UP will again present comments in the order of topics in the Board's Advance Notice of Proposed Rulemaking, served March 31, 2000. We will then discuss several proposals from passenger train operators and a handful of procedural issues.

One unique comment does not fit into that framework, however, so we address it first. KCS asks the Board to apply the future merger rules and policies to any oversight

proceeding still open when these rules are enacted. KCS, p. 20.¹ Under established principles and Supreme Court precedent, that would not be lawful.

KCS's interest is clear enough: having lost three attempts in the UP/SP proceeding to expand affiliate Tex Mex's rights to serve the Houston area,² KCS seeks a new avenue for a fourth attempt. Were the Board to apply its new rules to railroads subject to continuing oversight, KCS presumably would ask the Board to add new conditions to the UP/SP merger during the final year of Board oversight.³

The Board properly recognized that the new rules it is developing will apply only to future mergers. Notice of Proposed Rulemaking served Oct. 3, 2000 ("NOPR"), p. 9. The Board should not and cannot retroactively change the rules applicable to prior mergers. See, e.g., UP Opening Comments on Proposed Merger Rules, 6-7 & n.3. This is equally true for the four Class I railroads still subject to oversight proceedings: UP, CSX, NS, and CN/IC. As the Supreme Court said in Hughes Aircraft Co. v. United States ex rel. Shumer, 520 U.S. 939, 944-46 (1997), the presumption against retroactivity is "time-honored," and it is impermissible to apply a new rule to pending claims without express Congressional authority. See also Davey v. City of Omaha, 107 F.3d 587, 592-93 (8th Cir. 1997) (amendment to Title VII cannot be applied retroactively because Congress did not specifically declare the amendment would apply retroactively and it "attaches new consequences to prior conduct and significantly alters the legal

¹ Unless otherwise indicated, all citations are to comments filed on November 17, 2000.

² Finance Docket No. 32760, Union Pac. Corp. – Control and Merger – Southern Pac. Rail Corp. ("UP/SP"), Decision No. 44 served Aug. 12, 1996, pp. 147-51; Decision No. 62 served Nov. 26, 1996; UP/SP, Decision No. 63 served Dec. 4, 1996, p. 4; Finance Docket No. 32760 (Sub-No. 26), Union Pac. Corp – Control and Merger – Southern Pac. Rail Corp [Houston Gulf Coast Oversight], Decision No. 10 served Dec. 21, 1998, pp. 10, 16-18.

³ The five-year UP/SP oversight period is scheduled to end three weeks after the Board issues its new merger rules.

terrain that employers must traverse”); Chenault v. United States Postal Service, 37 F.3d 535, 539 (9th Cir. 1994) (holding that “[r]egardless of whether a statute is ‘substantive’ or ‘procedural,’ it may not apply to cases pending at the time of enactment if the new statute would prejudice the rights of one of the parties.”)

KCS also asks the Board to create a new rule stating that the Board will use its conditioning power to address in future mergers “harms to competition resulting from previous mergers involving the current merger applicants.” KCS, p. 16.⁴ UP agrees with KCS that when a merger undermines a condition imposed in a prior merger, the condition should be replaced. KCS, pp. 17 n.6, 28-29. In such situations, a new condition is appropriate because the second merger would otherwise adversely affect competition. But if KCS wants new conditions to address circumstances that did not justify conditions under the rules and precedents applicable to a prior merger, its request contravenes the principle against retroactivity. KCS’s request also violates a principle KCS itself advocates: that the Board should impose conditions only to address effects of the merger before the Board. Id. at 11, 13.

In UP/SP, the Board reserved oversight jurisdiction only for the express purpose of determining “whether the conditions we have imposed have effectively addressed the competitive issues they were intended to remedy.”⁵ The Board said it would impose additional conditions only “if and to the extent, we determined that conditions already imposed were not

⁴ Assuming KCS is referring to recent mergers, its premise that mergers harmed competition is mistaken. Board and ICC conditions addressed all competitive harms from recent mergers.

⁵ UP/SP, Decision No. 44 served Aug. 12, 1996, p. 146. See also Finance Docket No. 32760 (Sub-No. 21), Union Pac. Corp. – Control and Merger – Southern Pac. Rail Corp. [General Oversight] (“UP/SP Oversight”), Decision No. 16 served Dec. 15, 2000, p. 13.

effectively addressing competitive harms caused by the merger.”⁶ UP consummated the UP/SP merger in reliance on the conditions the Board imposed, not broader conditions KCS or others might prefer in the future. The Board may replace only conditions that fail, if any; it can do no more.

The Board has found for four years running that the conditions it imposed in UP/SP are effective. The competition provided by BNSF and (for traffic to and from Mexico) Tex Mex continues to flourish.⁷ Unless those conditions suddenly and unexpectedly fail, the Board cannot change the conditions it imposed on the UP/SP merger without violating UP’s rights.

I. DOWNSTREAM EFFECTS

The comments reveal a broad consensus that the Board should consider how responses to any Class I merger would affect the public interest.⁸ The commenters, save only BNSF, CN, and WC⁹ agree that “downstream” analysis is important to assure that the Board

⁶ UP/SP General Oversight, Decision No. 10 served Oct. 27, 1997, pp. 2, 3-7; Decision No. 13 served Dec. 21, 1998, pp. 8-10; Decision No. 15 served Nov. 30, 1999, pp. 5-6; Decision No. 16 served Dec. 15, 2000, pp. 1, 6.

⁷ Tex Mex will be an even more effective competitor thanks to UP’s agreement to sell it a more direct rail route south of Houston. Finance Docket No. 33914, Texas Mexican Ry.—Purchase Exemption—Union Pacific R.R., Decision served Dec. 11, 2000.

⁸ See Canadian Pulp and Paper Ass’n, p. 3-4; Committee To Improve Am. Coal Transp. (“IMPACT”), p. 18; CSX, p. 12; Council of Forest Indus. & Western Canadian Shippers Coalition (“COFI/WCSC”), p. 4; E. I. du Pont de Nemours and Co. (“DuPont”), p. 5; The Fertilizer Inst. and the Canadian Fertilizer Inst., p. 12; IMC Global Inc., p. 3; National Indus. Transp. League, p. 31; NS, p. 51; Ohio Rail Dev. Comm’n, p. 11; Port of Seattle, p. 2; PPG Indus., p. 3; Proctor & Gamble Co., p. 6; Shell Oil Co. & Shell Chemical Co., p. 11; Transportation Intermediaries Ass’n. (“TIA”), p. 2; U.S. Dep’t of Agric. (“Agriculture”), p. 21; U.S. Dep’t of Defense (“DOD”), p. 5; U.S. Dep’t of Transp. (“DOT”), p. 20; Williams Energy Serv., p. 16.

⁹ See, e.g., BNSF, pp. 43-45 (opposing downstream analysis other than responsive mergers filed during the merger review); CN, pp. 16-20 (recognizing prospect of transcontinental duopoly but objecting to downstream analysis); WC, pp. 11-12 (objecting to downstream analysis).

fully understands the impact of the proposed merger. An almost equally broad consensus, however, believes that the Board's proposed rule on downstream merger applications (proposed § 1180.6(b)(12)) relies too much on speculation. BNSF and CN agree.

The proposed rule requires applicants to "anticipate what additional Class I merger applications are likely to be filed in response to their own application and explain how, taken together, these applications could affect the eventual structure of the industry and the public interest." Under another proposed rule, applicants must calculate public benefits "in light of the anticipated downstream mergers." Proposed § 1180.1(i). These rules require a rigorous downstream analysis, but if the applicants guess wrong, that analysis will have little value. The analysis may also ignore important public policy questions. And applicants may deny that any responsive merger is likely.

The important public policy questions in the next major Class I merger proceeding will focus on whether a North American railroad duopoly is in the public interest. The Board will choose between a future in which two huge transcontinental systems develop single-line services in isolation from each other and a future in which all remaining railroads strive to develop more efficient services over remaining interline routes. This is an important choice that can be made only once, because mergers are likely to be permanent. Asking applicants to predict and discuss specific future merger permutations could easily miss this central inquiry.¹⁰

While most commenters endorse downstream analysis and worry about speculation, they generally fail to offer alternatives for the Board to consider. Thus, the U.S. Department of Transportation ("DOT") recommends that "the STB should set forth more

¹⁰ For example, if BNSF and CN again propose to merge, they might confine their "downstream" analysis to a hypothetical UP/CP merger.

specifically what is required of applicants and how it will consider the evidence submitted.”

DOT, p. 21. In contrast, UP provided the Board with a simple yet instructive solution. The Board and applicants should evaluate the impact of a major Class I merger on the assumption that it is part of an “end game” resulting in only two major North American railroads. If the Board then approves a merger, it should condition the merger to protect the public interest in that final industry structure.¹¹ Thus, the Board should strike the last two sentences in proposed § 1180.1(i) and replace its proposed § 1180.6(b)(12) with the following language:¹²

Applicants proposing a major transaction must evaluate the effects on competition and the public interest of combining all Class I railroads in the United States and Canada into two North American Class I railroads. Applicants need not identify specific combinations, but should evaluate the implications of an industry structure consisting of two major railroads.

II. SAFEGUARDING RAIL SERVICE

Commenters broadly applaud the Board’s proposals to prevent the service problems that followed three recent large consolidations. The proposed rules call for detailed implementation and contingency planning, post-consummation monitoring, and problem-resolution mechanisms such as a Service Council of affected parties. Proposed § 1180.1(h). The Board also encourages applicants to negotiate service agreements with shippers and connecting carriers, and it offers its good offices to resolve problems informally. NOPR, p. 20.

Yet there are concerns about this framework. Numerous shippers, shipper groups, and federal and state agencies object that the Board fails to provide any financial remedy for

¹¹ UP also reminds the Board of UP’s related proposal to consolidate contemporaneous applications proposing major transactions into a single merger review proceeding.

¹² If a smaller Class I carrier believes that a specific transaction is unlikely to lead to downstream transactions, it could seek exemption from this rule.

service failures that could arise after future mergers.¹³ Rail carriers fear that placing too much emphasis on service agreements would give shippers and connecting carriers too much leverage in negotiations. AAR, pp. 21-22. UP and KCS urge the Board to require disclosures of any agreement that might bias the views of commenting parties or affect the way the merger will be implemented. KCS, p. 14; UP, p. 10.

In light of the comments, UP modifies its recommendations as follows:

1. UP is persuaded that service agreements can play a useful role in protecting shippers and connecting carriers against service failures. Commenting shippers do not appear to share UP's concerns about potential misuse of these agreements. Accordingly, UP withdraws its objection to such agreements. We continue to join AAR in urging the Board to create a level playing field for negotiations. Applicants should be encouraged to negotiate agreements, but failure to do so should not be prejudicial.
2. UP continues to believe that agreements should be disclosed and filed with the Board if the non-applicant party submits comments on the merger

¹³ American Chemistry Council/American Plastics Council ("ACC/APC"), p. 14; American Forest & Paper Ass'n, p. 5; Alliance for Rail Competition, p. 5; American Short Line & Regional R.R. Ass'n, p. 3; BASF Corp., p. 24; California PUC, p. 4; Certain Coal Shippers: (Otter Tail Power Co., Public Serv. Co. of Colo., Southwestern Pub. Serv. Co., TUCO, Inc., Tucson Elec. Power Co., and Western Resources, Inc.), pp. 16-18; IMPACT, p. 18; DuPont, p. 5; Edison Elec. Inst., p. 9; Farmrail System, Inc., pp. 8-9; Finger Lakes Ry., pp. 8-9; IMC Global Inc., p. 4; National Grain and Feed Ass'n, pp. 11-13; National Indus. Traffic League, p. 21; North Am. Freight Car Ass'n, p. 2; National Mining Ass'n, p. 2; North America Freight Car Ass'n, pp. 4-5; North Dakota Pub. Serv. Comm'n, North Dakota Grain Dealers Ass'n, North Dakota Wheat Comm'n, North Dakota Barley Council ("North Dakota Parties"), p. 2; Oklahoma Dep't of Transp., p. 2; Pennsylvania House Transp. Comm., p. 2; PPG Indus., p. 2; Subscribing Coal Shippers, p. 22; TIA, p. 2; Agriculture, p. 19; DOD, p. 6; U.S. Clay Producers Traffic Ass'n, Inc., p. 4; Weyerhaeuser Co., p. 4.

or if the agreement affects merger implementation. The Board and other parties need to understand the motivations of those commenting on a merger. Moreover, the Board's detailed implementation planning could be undermined if service agreements require changes in the Service Assurance Plan.¹⁴

3. If merger applicants reach service agreements with a shipper, the Board should assume that those agreements address all of the shipper's financial claims associated with potential service failures. The Board should not provide a separate regime of remedies that may conflict with or undermine the parties' agreements.
4. UP continues to recommend that the Board provide a base level of financial protection for shippers who do not negotiate service agreements.¹⁵ Those shippers, including small shippers who may lack the resources or bargaining power to reach agreements with applicants, deserve a remedy if they suffer substantial and harmful service failures. UP is the only party to offer a concrete proposal for service remedies. Our detailed proposal defined the data requirements for measuring service before and after a merger and the circumstances under which a remedy would be available.

¹⁴ Contracting parties could treat as confidential their agreements' commercially sensitive financial terms and financial remedies for service failures.

¹⁵ As AAR points out in its reply comments, railroads have ample motivation to avoid service failures without new Board remedies.

Several parties argue that the Board could protect service by excluding the costs of service failures from variable costs in rate reasonableness cases. The Board's recent decision in Finance Docket No. 33726, Western Coal Traffic League v. Union Pacific R.R., Decision served Nov. 30, 2000, disposes of these requests. As the Board has repeatedly held, merged railroads accounted properly for service costs. In any event, it would be difficult if not impossible to separate such costs from normal operating costs, greatly prolonging any affected rate case. Railroads have far greater incentives to avoid service failures than a recalculation of revenue-to-variable-cost ratios in rate cases.¹⁶

III. PRESERVING AND ENHANCING COMPETITION

UP supports the Board's conclusion that "it is appropriate to require merger applicants to bear a heavier burden to show that a major merger proposal is in the public interest." NOPR, p. 10. With its proposed rules, however, the Board breaks from its historical practice of requiring applicants to preserve competition by remedying every substantial loss of competition. Instead, it requires applicants "to provide a plan for enhancing competition." NOPR, p. 13. This is the wrong approach to raising the bar for merger applicants.

UP supports the following principles:

- The Board can and should remedy every substantial competitive harm.
- If the Board concludes that it cannot fashion a remedy for a substantial harm to competition, then the Board should reject the merger application.

¹⁶ Moreover, this remedy would benefit few shippers: those who bring rate cases in the year or two after service failures arise.

- The Board should not require or impose new competition unrelated to the harms of the proposed merger. AAR's comments explain why this would be undesirable public policy and perhaps illegal. AAR, pp. 6-19.¹⁷

A. Gateway Preservation

Numerous commenters, including many shippers and smaller railroads, urge the Board to ensure that future mergers preserve established routes via gateways.¹⁸ They are concerned that the Board's requirement of an "effective plan" to keep open "major existing gateways" (NOPR, pp. 15-16) is too vague. Although UP does not agree that end-to-end mergers generally have anticompetitive vertical effects, UP offered a concrete suggestion to address this widespread concern. UP, App. A, pp. 33-34.

UP proposed that the Board modify its rules to require combining carriers to make available at a shipper's request separately challengeable "bottleneck" rates between exclusively served facilities on their system and the predominant pre-merger gateway for each type of traffic at those facilities. UP again recommends this proposal as the best way to address concerns about lack of specificity in the gateway rule.

¹⁷ UP agrees with those who ask the Board to clarify that any party may propose conditions to preserve competition, not merely the applicant carriers. BASF Corp., p. 20; KCS, p. 18; State of New York, p. 19; Agriculture, p. 19; Williams Energy Serv., pp. 4-5. Parties harmed by a proposed merger have strong incentives to propose conditions that will remedy the harm. As long as these conditions are tailored to meet the merger-specific harm identified, the Board should consider whether the proposal is the optimal solution. Proposed conditions from third parties deserve the same treatment as proposed conditions from the applicants themselves, as has long been the case in merger proceedings.

¹⁸ ACC/APC, pp. 3-8; Ameren Serv. Co., p. 3; American Forest & Paper Ass'n, p. 5; Edison Elec. Inst., p. 10; North Dakota Parties, p. 3; Pennsylvania House Transp. Comm., p. 2; PPG Indus., p. 2; Weyerhaeuser Co., p. 6.

The Board should reject more expansive proposals to preserve or expand gateways. For example, merging railroads should not be required to preserve every interchange point, as a few parties suggest.¹⁹ Since the Staggers Act, railroads have improved efficiency by closing little-used interchanges in favor of higher-volume, more efficient gateways. Most shippers benefited from this trend, which facilitated more efficient blocking, more frequent service, and lower costs via the remaining gateways. The Board properly limited its proposed rule to “major” gateways affected by a proposed merger.

The Board also should reject the suggestions that it impose on all carriers serving an affected gateway the same gateway condition it imposes on the applicants. DOT argues that “if the rule applied only to the merging railroads, they would be put at a competitive disadvantage compared to other competing railroads serving the gateway.” DOT, p. 5. AAR’s reply comments explain why this would be unlawful.

Moreover, DOT’s position is illogical. Keeping a gateway open merely preserves the status quo. For example, in a hypothetical NS-BNSF merger, the condition would require NS to continue to exchange traffic at St. Louis with UP and Gateway Western, as well as with its merger partner BNSF. BNSF would maintain service with CSX as well as NS. UP, Gateway Western, and CSX would continue to exchange traffic with the merged carriers, NS and BNSF. The merged entity would suffer no disadvantage from continuing to do what it does today. On the contrary, it alone could offer single-line service, a potential advantage.

¹⁹ E.g., ACC/APC, pp. 3-8.

Similarly, the Board should reject proposals to require merger applicants to reopen closed gateways.²⁰ Such a condition would not address any effect of a future merger proposal and would accordingly exceed the Board's authority, as discussed in AAR's and UP's prior comments. AAR, pp. 15-19. Moreover, this proposal would destroy the efficiencies that predominantly parallel mergers achieved in recent decades by consolidating traffic on the most efficient routes.

Even more unjustified are proposals for various new forms of rate regulation designed to ensure that gateways are kept open "commercially." For example, Bunge suggests that a gateway preservation rule must limit the ability of railroads to increase rates for traffic over the gateway and even prohibit rate reductions for other customers. See Bunge Corp., p. 5.²¹ These proposals resemble the "DT&I Conditions" that the Commission revoked as anticompetitive following the Staggers Act. In Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Proceedings, 366 I.C.C. 112, 123-24 (1982), the Commission explained that DT&I Conditions were "economically inefficient since they would hamper a newly consolidated carrier from realizing potential costs savings from consolidation." Id. at 124. UP's proposed rule, by contrast, would give carriers flexibility to adjust their rates to reflect the relative efficiencies of alternative gateways and new single-line service created by their merger, subject only to rate reasonableness constraints.

²⁰ See Weyerhaeuser Co., p. 6; see also KCS, p. 16 (stating the Board should use its conditioning power to remedy harms to competition resulting from previous mergers involving the current merger applicants).

²¹ See also ACC/APC, p. 6 (expand rate regulation to keep gateways open).

B. Divestitures and Trackage Rights

The Committee to Improve American Coal Transportation (“IMPACT”) and IMC Global, Inc. (“IMC”) ask the Board to preserve competition by ordering divestitures rather than relying on the proven remedy of trackage rights. IMPACT, pp. 23-24; IMC, pp. 3-4. This recommendation makes little sense for future mergers, which are likely to be predominately end-to-end. In a parallel merger, divestitures would preserve separate ownership of parallel lines, albeit by destroying efficiencies. In the UP/SP merger, for example, proposed divestitures would have prevented one of the major benefits of the merger: directional operations on hundreds of miles of track between Mississippi River gateways and Texas. In an end-to-end merger, divestitures would destroy single-line service and eliminate the economic rationale for the merger.

The Board recognizes that divestitures destroy merger benefits by preventing the merged carrier from eliminating redundant facilities and combining traffic flows. The Board therefore disfavors divestitures: “Divestiture in the rail industry, with its network economies, is a requirement to be imposed only under extreme conditions when no other less intrusive remedy would suffice.” UP/SP, Decision No. 44 served Aug. 12, 1996, p. 157. As the Board explained, “divestiture would add an additional railroad, reducing volume efficiencies, despite the fact that the merger as conditioned will not result in competitive harm. And divestiture will be a significant overreach because it would transfer large volumes of business at exclusively served points to the acquirer, without any competitive justification.” Id. at 158. Perhaps most troubling is the danger that “divestiture proposals would also take the railroad system backwards by destroying, rather than creating, single-line service.” Id.

Given the evils of divestiture, the Board should retain its preference for trackage rights. BNSF’s success using trackage rights on UP proves that trackage rights are highly

effective. BNSF's reports to the Board provide numerous examples of new trackage rights services that compete vigorously with UP. See UP/SP, BNSF-PR-16, Burlington Northern and Santa Fe Railway Company's Quarterly Progress Report, filed July 3, 2000. For example, BNSF recently initiated intermodal service between the United States and Mexico City using Texas trackage rights, id. at 3; unit coal trains from the Powder River Basin to Mossville, Louisiana, over Gulf Corridor trackage rights, id. at 5-6; and additional merchandise trains between the Pacific Northwest and California over its I-5 Corridor trackage rights, id. at 13. As a result of these and other successes, "BNSF traffic volumes over the lines to which BNSF received access as a result of the [UP/SP] merger have continued to grow." Id. at 21. Observing declining rail rates in the West (3.1 percent per year adjusted for inflation), the Board stated that this evidence "indicate[s] vigorous competition and improved service in the West." UP/SP General Oversight, Decision No. 16 served Dec. 15, 2000, p. 6. The Board therefore found that "BNSF has become a strong competitor to UP where it provides service under trackage rights as a result of the merger." Id. In light of these findings, there is no justification for choosing divestitures over trackage rights.

The National Mining Association ("NMA") is concerned that trackage rights are sometimes more circuitous than the merged carrier's other routes. NMA, pp. 2-3. The Board has correctly prescribed trackage rights that replicate the competition that the merger would have extinguished, employing the former competitor's route. Thus, BNSF serves the Central Corridor using the somewhat longer SP route through Colorado because BNSF replicated SP's competitive role. The Board should continue this practice.

C. Intermodal Competition

Under the guise of raising concerns about competition, two commenters urge the Board to restrict railroad intermodal policies and procedures. CrossRoad Carriers and the

Transportation Intermediaries Association (“TIA”) argue that the railroads “have begun erecting artificial barriers that eliminate[] or restrict[] small-medium size shippers. This is being done through excessive unreasonable guaranteed volume requirements, exorbitant penalty provisions and unnecessary bonding requirements.” CrossRoad Carriers, p. 2; see also TIA, p. 3. TIA and CrossRoad Carriers dress up these complaints as applying to all smaller shippers, but this is misleading. These concerns apply only to intermodal transportation, where the economics of the business are driving a wave of consolidation among marketing companies.

These intermodal grievances have nothing to do with mergers and should not be considered in this proceeding. Moreover, intermodal traffic is exempt from regulation because it is structurally competitive. Petition to Exempt Rail Movement of New Trailers and Containers from Regulation (49 C.F.R. Part 1039), 3 I.C.C.2d 751 (1987). Future mergers pose no risk to competition in intermodal transportation.

IV. THREE-TO-TWO ISSUES

The Board should maintain its case-by-case approach in reviewing 3-to-2 situations.²² A few commenters argue that when the number of rail options falls from three to two, shippers invariably suffer a loss of competition that the Board must remedy. Decades of experience, however, show that two viable rail carriers compete as effectively as – or even more effectively than – three carriers. For example, in the UP/SP merger, the Board examined every alleged “3-to-2” issue in detail and concluded that the merger, coupled with the trackage rights granted to BNSF, would invigorate competition despite the elimination of SP as an independent third competitor. Where the Board believed that one of the remaining competitors

²² Given the likely end-to-end nature of future major railroad mergers, UP questions the value of reconsidering the Board’s approach to 3-to-2 situations. Only a very small percentage of rail customers have three or more rail options.

could not be fully effective, the Board imposed a condition. UP/SP, Decision No. 44 served Aug. 12, 1996, pp. 152-53.²³

Three-carrier competition can be weaker than competition by two strong railroads. The UP/SP merger provided examples of situations where splitting traffic three ways left SP to “retrench its services or possibly to dismember itself.” UP/SP, Decision No. 44 served Aug. 12, 1996, p. 160. The Board therefore concluded that two-carrier competition would be stronger than the limited competition that resulted from dividing traffic three ways. In its subsequent oversight proceeding, the Board has repeatedly found that two-carrier competition between UP and BNSF is vibrant.²⁴

Under appropriate circumstances, the competition provided by a third carrier should be preserved. The Board should continue to examine each situation on its facts, without applying a presumption one way or the other. If the evidence in a particular case demonstrates that the railroad competing with a merged carrier would be unable to provide effective competition, the Board can and should introduce an effective third competitor.

V. PUBLIC BENEFITS AND HARMS

A. Merger-Specific Benefits

Aside from the two railroads that recently proposed a merger, most commenters endorse the Board’s proposal to require “substantial and demonstrable public benefits to the

²³ KCS’s positions on this point are irreconcilable. It argues that every reduction in intramodal competition causes competitive harm. KCS, pp. 8-9. Only a few months ago, though, KCS argued that the Board should eliminate BNSF as a third competitor against KCS at Lake Charles, Louisiana. UP/SP General Oversight, Decision No. 16 served Dec. 15, 2000, p. 12.

²⁴ See n.6 above.

transaction that cannot otherwise be achieved.” Proposed § 1180.1(a) (emphasis added). This is an appropriate way to “raise the bar” for future mergers.

As discussed above, in the next major merger proceeding the Board will face a choice between two fundamentally different futures for the rail industry. The basic issue in the next transcontinental merger proceeding is whether the nation will be better served by permanently restructuring the remaining carriers into large, increasingly isolated systems or encouraging carriers to use innovative contractual and joint arrangements to improve service and achieve greater efficiency.²⁵ Each option offers opportunities to improve service, enhance competition, and achieve greater economic efficiency, but each also carries risks.

BNSF strenuously objects to the Board’s proposal to consider only merger-specific benefits. BNSF states that “The NPR . . . would create barriers to future mergers by allowing the Board to decide whether the claimed benefits of any merger could be achieved through means short of merger, such as alliances and marketing arrangements, that no party has actually proposed.” BNSF, p. 40. The Board should defer, BNSF asserts, to the decisions of the two applicants’ managements in deciding that mergers are the preferred way to advance the public interest. *Id.* at 40-41.

Contrary to BNSF’s assertions, the Board’s decision harmonizes well with the procedures used by antitrust agencies and the federal courts to review mergers. The FTC and DOJ apply nearly identical requirements in reviewing mergers. *See, e.g.*, 1992 United States Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines § 4

²⁵ Until recently, American companies trailed those in Europe and Asia in using alliances. American businesses are rapidly moving toward alliances, which reportedly provide higher returns to stockholders than mergers. John R. Harbison & Peter Pekar, Jr., Smart Alliances: A Practical Guide to Repeatable Success (1998).

(revised April 8, 1997) (“The Agency will consider only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies.”). The federal courts accept that if efficiencies are to be considered at all, they must be merger-specific. See, e.g., FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 62 (D.D.C. 1998) (“In light of the anti-competitive concerns that mergers raise, efficiencies, no matter how great, should not be considered if they could also be accomplished without a merger.”). Given the overwhelming support for this proposed change to the Board’s merger rules, the Board should adhere to its decision to disfavor future major transactions “unless there are substantial and demonstrable public benefits to the transaction that cannot otherwise be achieved.” Proposed § 1180.1(a).

The current proposal is deficient in one minor respect. To determine whether the identified benefits are merger-specific, the Board should require applicants to explain why the benefits they propose cannot be achieved through alliances, joint ventures, or other inter-railroad arrangements. Proposed § 1180.6(b)(11) (titled “Calculating public benefits”) makes no mention of the requirement that public benefits be merger-specific. The Board should rectify this ambiguity to ensure it receives the information necessary to perform the public interest analysis described in proposed § 1180.1(c).

B. Merger Harms

The Board should ensure that it considers all harms resulting from a merger. UP disagrees with several of the views presented in this proceeding about what constitutes a merger harm. Several alleged harms identified in the comments are unrelated complaints or opportunistic private desires. Nevertheless, the Board should broaden its proposed § 1180.1(c)(2) to include not only losses of competition and transitional service problems but

also losses of efficiency and long-term damage to service. The Board should draw a conclusion about the net public benefit or harm of a merger.

In its proposed rules, the Board lists three public harms: reduction of competition, harm to essential service, and transitional service problems. Now that most redundant capacity has been removed from the rail system, the Board should add to its list other potential “costs” of the merger.” Proposed § 1180.1(c)(2). For example, a proposed merger might reduce service quality for shippers located on connecting lines. It might export costs to other carriers, as a BNSF/CN merger would have by diverting transcontinental traffic to interchanges in Buffalo instead of the traditional Chicago gateway. Existing alliances or joint ventures might be damaged or even destroyed by a proposed merger. For example, if the Board had approved the proposed BNSF/CN merger, KCS expected its alliance with CN to atrophy.²⁶ A combination might also eliminate multi-carrier cooperative opportunities that otherwise would have been pursued. For example, if two railroads that connect in Chicago merge, they are likely to invest their time and money in improving their route through Chicago rather than in solving the industry’s mutual problems in that crowded terminal. The Board should weigh each of these costs of the merger in assessing whether the proposed merger is in the public interest.

²⁶ At the Ex Parte No. 582 hearing, Michael R. Haverty, President and Chief Executive Officer of KCS predicted that, if BNSF and CN combined, “We do not feel that long term the CN-IC-KCS marketing alliance is going to survive.” Ex Parte No. 582, Public Views on Major Rail Consolidations, Mar. 7, 2000 transcript, p. 187.

C. Penalties for Unrealized Benefits

Several parties ask the Board to penalize applicants who are unable, for whatever reason, to achieve predicted merger benefits. UP has already discussed its concerns about the failure of the proposed rules to recognize how circumstances change after a merger application is filed. See UP, pp. 15-18. UP's concerns would be magnified if the Board expands rather than removes the risks to a merged carrier that fails to realize all anticipated merger benefits.

There are serious practical problems with imposing penalties for unrealized benefits. Unlike service failures, no one suffers direct harm from unrealized merger benefits. As an example, during the Conrail merger proceeding, the parties predicted significant intermodal traffic gains in the I-95 Corridor. Those traffic gains have not yet materialized, although they may in the future. This delay does not, however, justify penalizing CSX or NS further; they are already forgoing the revenues from those new services. No "loss" can be quantified, and it would be impossible to determine which shippers suffered a loss. Imposing penalties on railroads that have already lost anticipated revenues would also reduce their ability to initiate the service.

Penalties for unrealized benefits also would be contrary to the public interest. As the Board is well aware, the entire rail industry has struggled since the Staggers Act to achieve an adequate rate of return on capital investments. Robert Krebs, former CEO of BNSF, reminds us that "the greatest challenges facing the railroad industry and its customers today are (1) improving service to rail shippers and (2) attracting the capital investment needed to obtain efficiencies from the existing rail infrastructure and, where necessary, to construct new infrastructure to support improved rail service offerings." BNSF, Verified Statement of Robert D. Krebs, pp. 1-2. Imposing financial penalties for failing to achieve merger benefits would curtail

the ability of the merged carrier to invest in its infrastructure, hampering its ability to serve existing customers and improve service.

D. Presumptions Regarding End-to-End Mergers

Several parties suggest various presumptions regarding the public benefits (or lack thereof) from end-to-end mergers. The most powerful argument against adopting any presumption is the lack of consensus in the comments. Compare BNSF, pp. 23-27 (describing potential benefits of future major mergers), with Texas Crushed Stone Co. and Georgetown R.R. Co., pp. 4-7 (questioning whether any future major mergers could be in the public interest).

There is no basis in the record for any presumption, favorable or negative, regarding the public benefits or harms of end-to-end mergers. While many shippers see single-line service as a benefit, others prefer to retain their remaining routing options. The Board should develop a record on a specific merger application instead of resolving this conflict in the abstract.

VI. CROSS-BORDER ISSUES

Most parties commenting on cross-border issues, including three federal agencies, agree that the Board should fully explore the implications of cross-border transactions.²⁷ As the Board's proposals recognize, the Board and interested parties need to understand the systemwide operations of a cross-border railroad. The Board and interested parties also need to understand the competitive effects on U.S. transportation of activities wholly or partly in another country.

²⁷ E.g., Agriculture, p. 22; DOD, pp. 6-7; DOT, p. 21; COFI/WCSC, p. 4; Weyerhaeuser, p. 5.

CN critiques the Board's proposed rules because it believes they are inconsistent with the policy objectives of NAFTA. CN, p. 23. CN mischaracterizes the Board's proposals, arguing that they impose additional requirements on foreign applicants simply because they are foreign. In fact, proposed § 1180.1(k) seeks to gather the same information from foreign applicants that it would draw from domestic applicants. The Board and interested parties need this information from foreign applicants so that they can determine what impact the cross-border transaction will have on the U.S. rail network and public interests. In other words, proposed § 1180.1(k) allows the Board to hold foreign applicants to the same standards as domestic applicants, in conformity with the policy objectives of NAFTA.

In cross-border mergers, the applicants should be required to demonstrate that major gateways on the merged system will remain open, even if those gateways are wholly within another country.²⁸ The "'full system' competitive analyses and operating plans" required by § 1180.1(k) will enable the Board to review whether the applicants in a cross-border merger intend to preserve major gateways on their system, and will thus permit the Board to consider the application on the same terms as an application submitted by two domestic carriers. Under no circumstances should the Board allow applicants to determine unilaterally whether their foreign activities will have impacts on U.S. interests.

VII. PASSENGER SERVICE ISSUES

More than half a dozen parties offer comments addressing treatment of rail passenger service in merger proceedings. At first glance these comments may appear to be innocuous, but the more extreme suggestions pose major risks to the nation's freight transport

²⁸ The American Chemistry Council and the American Plastics Council agree that "[k]eeping gateways and interchanges open and effective should be a common goal on both sides of the Canadian-US border." ACC/APC, p. 5.

system. If the Board adopts such proposals, it may cripple the rail industry's ability to meet the growing need for goods transport in the U.S. Such rules would also motivate freight railroads to resist new commuter rail service on their lines. The Board should step carefully in this minefield of proposals.

We begin by reviewing the capacity shortage on the nation's freight railroads and the tradeoffs between freight and passenger services. We then discuss a few of the many requests for changes in the Board's proposed rules.

A. The Capacity Crunch

Capacity on the freight railroads is a highly valuable but scarce resource. As New Jersey Transit Corp. ("NJT") explains, "the largest railroads have reduced most or all of their excess capacity." NJT, p. 5. The capacity crunch is especially acute in rail corridors serving metropolitan areas. Freight shippers, Amtrak, ports, and local transportation agencies all want to use the limited trackage serving major cities such as Los Angeles, Seattle, New York and Baltimore.

New capacity is expensive, and the railroads cannot easily afford it. Governments may find a billion dollars to build a new highway bridge over the Potomac River between Virginia and Maryland or rebuild the Mixing Bowl (the I-95/I-395/I-495 interchange in Virginia), but railroads do not have that kind of money. Adding rail capacity to routes in metropolitan areas is even more expensive because of the density of urban development and continuing suburban sprawl.

America can preserve the nation's rail freight network only by replacing the capacity that additional long distance and commuter trains consume. Every additional passenger train occupies scarce freight capacity. Unless that capacity is replaced, both the availability and quality of freight service will decline. If public policies, including the Board's merger rules,

divert freight capacity to passenger service without replacing that capacity, rail freight service will be strangled and freight will move in other ways. Most of it will move by truck. Thus, proposals to slow the growth of highway traffic by running passenger trains could put more trucks on the highways.

The damage passenger service inflicts on freight service is not hypothetical. Desperate for cash, SP sold two of its rail lines serving Los Angeles to the Southern California Regional Rail Authority ("SCRRA"). SCRRA's commuter operator, Metrolink, now controls UP freight operations on those lines. SP and Metrolink agreed to ban all freight service on these lines for several hours each workday morning and evening to ensure reliable commuter service. Metrolink's dispatching, designed to protect commuter schedules at all costs, often delays UP's intermodal and other freight services to and from the Los Angeles Basin. UP has virtually given up using the Metrolink-controlled line from Los Angeles north to Palmdale and the California Central Valley. UP has also curtailed freight service on the historic SP "Coast Line" through Santa Barbara. Instead, UP runs trains dozens of extra miles on already busy rail lines to avoid these bottlenecks. Ironically, this forces more trains onto a UP track between Los Angeles and Riverside that is also used by Metrolink commuter trains, causing some of the delays about which SCRRA complains. Maryland Mass Transit Administration and Southern California Regional Rail Authority ("MMTA/SCRRA"), pp. 2-3.

The Board should protect the nation's rail freight capacity. The country will need it in coming years to maintain both low-cost transportation of goods and passenger car mobility. Truck traffic is growing faster than the nation's highway system. As our busy roads and highways become increasingly congested, freight railroads are a critical and efficient alternative.

The Board should be equally vigilant in protecting freight capacity in merger proceedings and in other contexts. Railroads should not face government restrictions on their use of their own tracks merely because they are merging. The Board encourages privately owned railroads to provide new and improved freight services. That is a public benefit. For example, if UP is able to find an acceptable site for a new Chicago intermodal facility and triples its intermodal service between Chicago and Los Angeles, shippers will gain. UP is free to add those trains to its mainlines without governmental approval or interference. No different rule should apply when the new services result from a merger. Put differently, why should a merging carrier be penalized for providing the improved services that we encourage a non-merging competitor to provide without government restraint?

The Board therefore should abide by a guiding principle in designing its merger rules and in all other proceedings involving rail passenger service: if the Board imposes additional passenger operations on freight rail lines, it should require passenger rail operators to replace the freight capacity lost to passenger train service, in addition to paying all operating costs their trains impose.²⁹

B. Prior Consultation

UP agrees that the Board should require merger applicants to meet with passenger operators before completing service assurance plans.³⁰ Prior consultation should help applicants develop operating plans that accommodate existing passenger operations. Prior

²⁹ Even this compensation will not adequately reimburse the freight railroads for the costs they incur when they lose capacity to passenger trains. Each new increment of capacity generally costs more than the last. Freight railroads will be forced to pay more for the next increment of capacity as they add freight trains to their own tracks.

³⁰ DOT, p. 21; Metra, p.4; MMTA/SCRRRA pp. 9-10; NJT, pp. 9-10.

consultation also provides an opportunity to develop contingency plans for potential implementation problems.

C. The Public Interest Standard

UP agrees with the many comments that the Board should consider a merger's effects on existing rail passenger service.³¹ If a merger will facilitate better passenger service, that improvement should be counted as a public benefit. If the merger will reduce the quality of rail passenger service, that harm should be weighed in the balance against the merger. The Board must be very cautious, though, in conditioning mergers for passenger service.

D. Respecting Commuter Service Contracts

Commuter operators negotiate market-based contracts with freight railroads for shared use of tracks. The Board should not interfere with these contracts as some suggest. MMTA/SCRRRA, p. 4. If it does, freight railroads may refuse to sign them in the first place. If the Board ever does reopen commuter service contracts, it should consider whether the contracts provide adequate protection for freight service and, if not, require commuter operators to bear appropriate costs.

Contracts between freight railroads and commuter operators are as varied as the circumstances to which they apply. The frequency of commuter operations is an important factor. The new twice-per-day "Sounder" service on BNSF between Tacoma and Seattle imposes very different capacity and operating requirements than the dozens of trains per day that METRA operates on UP's Geneva Line west of Chicago.

³¹ Amalgamated Transit Union ("ATU"), p. 2; American Pub. Transp. Ass'n ("APTA"), pp. 3-4; MMTA/SCRRRA, p. 2; United Rail Passenger Alliance ("URPA"), pp. 2-3.

A critical component of these agreements is how much the commuter operator is willing (or can afford) to invest in capacity to offset the impacts of commuter service on freight service. The extent of that investment directly affects contractual performance standards. A freight railroad can guarantee superb reliability to a commuter operator willing to invest in enough capacity to completely eliminate interference with freight trains. An operator that invests less must expect lower standards of performance. The parties define their rights and obligations in their contracts, which usually provide performance guarantees and penalties for delayed trains. The Board should respect these contracts, because they provide the commuter operators with the level of service for which they negotiated.

For example, SCRRA complains about UP's delays to Metrolink trains on UP's Riverside Line. MMTA/SCRRA, pp. 2-3. SCRRA was unwilling to commit the investments to that line that UP suggested. Instead, the parties negotiated an agreement under which Metrolink trains are entitled to equal treatment with certain UP trains. Even though this performance standard necessarily means that UP trains sometimes delay Metrolink trains, Metrolink included little flexibility in its schedules to accommodate the level of performance it negotiated. Its complaint to the Board reflects the effects of its own inability to invest more in capacity.

E. The "Essential Services" Standard

Several parties applaud the Board for treating passenger services as "essential services." Commuter services probably are essential services in our congested cities.³² Applying the term "essential services" under the Board's merger rules, however, could have

³² We will not quibble about which Amtrak services are essential. It is doubtful that some of Amtrak's passenger services are essential. The Oklahoma City-Ft. Worth passenger train mentioned in the Oklahoma Department of Transportation comments may be an example.

pernicious effects. It is unlikely that any rail merger will ever threaten essential passenger service, but the proposed rule might be applied in inappropriate ways. In light of comments revealing these dangers, UP urges the Board to revise or clarify its rule.

The Board's current rules treat a freight service as "essential" if the public needs it and if there is no adequate substitute. 49 C.F.R. § 1180.1(c)(2)(ii). If a merger would so severely damage an essential freight service that it is no longer financially viable, the Board may impose conditions to preserve it. Mere diversion of freight and the resulting loss of revenues, however, require no remedy.

In keeping with this longstanding policy, the Board should clarify that it will not use the "essential service" label to create a new STB remedy for minor impacts on passenger service. Seven minutes of delay to a commuter train does not impair an "essential service," and the Board should not make itself a court of first resort for every dispute between merged carriers and passenger operators. The Board should not add conflicting or inconsistent remedies to those in passenger service contracts under the guise of protecting "essential services."

The Board also should not use the "essential services" rubric to require merged railroads to subsidize passenger services. The Rail Passenger Service Act relieved railroads of that burden. The Board should not reimpose it under its merger rules.

A rail merger may allow the merged carrier to achieve greater efficiency by discontinuing or reducing freight service over a rail line used by passenger trains. The passenger operator must then decide whether it wants to maintain passenger service over that line and incur a greater share of the costs. (Some commuter operators might be delighted to eliminate freight trains on lines they use.) The Board should not, by declaring a passenger service "essential," force the railroad to maintain the line for the passenger operator. There is no justification for

requiring the nation's freight railroads to subsidize a line for passenger service. Ultimately, however, that is what the commenting parties seek.³³

Given the likely end-to-end nature of future major mergers, proposed mergers probably will never pose a threat to an essential passenger service that the Board should remedy. UP recommends that the Board withdraw its proposal to treat passenger services as "essential services," or carefully consider how that term will be applied.

F. Requests to Divert Freight Capacity for Commuter Service

In several guises, APTA asks the Board to allow commuter operators to claim rail freight capacity for commuter use, granting them the equivalent of eminent domain power. APTA, p. 2. APTA claims that the Board should grant such "additional access rights" because mergers "aggravate the access challenges that passenger rail systems . . . already face." *Id.* APTA does not explain any connection between railroad mergers and the willingness of freight railroads to authorize commuter service. The UP/SP merger proves that there is no connection: UP is more receptive to commuter rail service than was SP before the UP/SP merger. APTA's request should be rejected as unrelated to this proceeding.

³³ URPA makes this clear. It wants the Board to force freight railroads to retain rail lines for passenger trains. URPA is mistaken, however, in believing that the UP/SP merger resulted in loss of Amtrak service to Phoenix "through abandonment or embargo of critical line segments." UP discontinued freight service west of Phoenix, and Amtrak could not afford the incremental cost of maintaining the line for its few trains. UP's action was unrelated to the merger. UP simply made an economic judgment in the interest of efficient freight operations. URPA also is wrong in claiming that "the UP-SP 'transaction' resulted in changes in rail traffic flows that have precluded the restoration of rail passenger service between Salt Lake City, Boise and Portland." Amtrak discontinued its "Pioneer" passenger train because it was uneconomic, not because of any change in UP operations.

URPA also suggests that UP prevented operation of a new passenger train via UP's mothballed but scenic Tennessee Pass line in Colorado. URPA, p. 2. Amtrak has never contacted UP about such a train. We doubt Amtrak would want to operate a train from Texas to Seattle on a route that misses Colorado's two largest cities.

APTA claims that mergers cause “competitive harm” to commuter rail projects, but it is impossible to see how. Rarely if ever do freight railroads compete for commuter rail service. Commuter service is usually a burden, not a benefit, for a freight carrier. Moreover, freight lines serve the same suburbs in very few places. This argument is a ruse for promoting what APTA calls “fair access” to rail lines. *Id.* at 4. “Fair access” to APTA means use of rail lines without paying full costs.

The Board must also reject requests by APTA and others to address the effects of mergers on “passenger rail systems that are in the planning and design stages.” *Id.* at 3. Putting aside the thorny question of how the Board would carry out that inherently speculative task, the request is unconstitutional. APTA wants the Board to reserve a private railroad’s property rights – its capacity – for future passenger service without compensation. This would bar the merged carrier from using its own tracks for new freight traffic. As APTA candidly admits, its request is a device to give commuter operators greater bargaining power in negotiations with railroads, an inappropriate justification. *Id.* at 2-3.

APTA also asks the Board to give commuter operators veto power over new freight service on lines commuter operators own. *Id.* at 5. This proposal obviously could impair new freight service. A commuter operator that owns a rail line has whatever right to curtail freight service it negotiated with a freight railroad. The Board should not rewrite those contracts to give commuter operators greater rights to harm the nation’s shipping interests. When a railroad owns a track, it should be free to expand freight services to the extent consistent with its contractual obligations.

G. Passenger-Related Oversight

UP also agrees that the Board should help identify constructive solutions to passenger service problems caused by merger implementation. UP does not agree that the

Board should provide financial remedies if such difficulties arise. Commuter service contracts already provide negotiated remedies for inadequate performance. Additional remedies imposed by the Board would conflict with contractual remedies and may unravel the compromises the parties reached.

H. Labor Protection for Transit Employees

The Amalgamated Transit Union (“ATU”) requests that proposed § 1180.1(e) be amended to provide “labor protection” for passenger and commuter rail employees who claim to be affected by Class I mergers. ATU seeks the same level of protection that the Board awards by law to employees of applicant carriers under 49 U.S.C. § 11326(a). ATU, p. 2.

Employees of non-applicant carriers (carriers not directly involved in a transaction governed by 49 U.S.C. § 11323) are not entitled to labor protection. UP/SP, Decision No. 60 served November 20, 1996), pp. 4-5; RLEA v. ICC, 914 F.2d 276, 280-81 (D.C. Cir. 1990); Crounse Corp. v. ICC, 781 F.2d 1176, 1192-93 (6th Cir. 1986); Southern Pacific Transp. Co. v. ICC, 736 F.2d 708, 725 (D.C. Cir. 1984); Lamoille Valley Ry. v. ICC, 711 F.2d 295, 323-24 (D.C. Cir. 1983); Missouri-Kansas-Texas R.R. v. United States, 632 F.2d 392, 410-12 (5th Cir. 1980). ATU offers no justification for ignoring this well-established rule. Moreover, many commuter railroads are “street, suburban, or interurban electric railways not operated as part of the general system of rail transportation.” See 49 U.S.C. § 10102(5). They are not “rail carriers” subject to Board jurisdiction and therefore are not covered by the labor protections of 49 U.S.C. § 11326(a). ATU’s request should be denied.

VIII. LENGTH OF PROCEEDINGS

The Board should conduct merger proceedings as expeditiously as possible consistent with exploring all relevant issues and reaching reasoned judgments. Under 49 U.S.C. § 11325(b), the Board must issue its decision within 15 months after acceptance of an

application. UP considers that time limit to be reasonable for the next major Class I merger.

A fifteen-month proceeding would permit the Board to apply its new rules, consider downstream effects, and review much more detailed service and market evidence. If the Board can give full consideration to these and other issues in a shorter period, it should endeavor to do so.³⁴

BNSF's proposal to curtail merger proceedings to only six to nine months is unreasonable. BNSF, p. 6.³⁵ Six to nine months would not be sufficient to determine the future structure of the North American rail system. For now, it would be premature to prescribe a highly expedited schedule for a Class I merger under rules that the Board has never applied.

The Board also should not sacrifice equitable scheduling in the interest of speed. In the BNSF/CN proceeding, the applicants sought a schedule that gave them disproportionate shares of a tight schedule.³⁶ BNSF's current proposal to impose a time limit starting with applicants' pre-filing notice is similarly biased. It would allow applicants to delay filing their application as long as possible, squeezing the time remaining for other parties to respond. The Board should not expedite its consideration of a merger application at the cost of building a proper record.

³⁴ The "cooling off period" proposed by IMPACT should also be rejected. That proposal would give the Board the power to "refuse to consider any merger application involving Class I railroads that is filed within 36 months after implementation of a previous merger of Class I's [sic]." IMPACT, p. 19. This proposal would encourage a counterproductive race to be the first to file and, in any event, would require a statutory change.

³⁵ BNSF proposes that a proceeding be decided within one year from the date of the pre-filing notification. BNSF, p. 6. The applicants would consume at least three months of that year, and possibly up to six, preparing their application.

³⁶ Finance Docket No. 33842, Canadian Nat'l Ry., Grand Trunk W. R.R., Illinois Cent. R.R., Burlington N. & Santa Fe Ry. – Common Control, BN/CN-8, Petition to Establish Procedural Schedule, filed Feb. 3, 2000.

The Board also should reject calls to extend the duration of the oversight phase beyond the current five-year period,³⁷ unless parties demonstrate that an extension is required in a particular case. Service problems following recent mergers have been resolved in less than five years. Experience with recent mergers shows that the effectiveness of competitive conditions can be evaluated within two to three years. After the UP/SP merger, for example, BNSF achieved its traffic goals for its trackage rights in about three years.³⁸ Protracted oversight proceedings would accomplish little except to impose costs on the merged carrier and provide a target for opportunistic competitors seeking new conditions.

IX. CLASSIFICATION OF CARRIERS

The Board's recent proposal to consolidate affiliated carriers for purposes of financial reporting confuses the potential application of the new rules.³⁹ UP proposes a solution that the Board should apply in merger cases whether or not it changes the financial reporting requirements. UP recommends that, for purposes of applying the merger rules, the Board should uniformly apply its financial classifications of carriers by combining affiliated carriers only to the extent they integrate their services to shippers.

Under this proposal, affiliated contiguous carriers would be combined because those carriers operate as a single system. Shortlines hundreds of miles apart would not be combined. This treatment would be appropriate. A merger of a large regional railroad with a Class I carrier may involve significant competitive and service issues. If it does not, the applicants might be able to justify waiver of this rule.

³⁷ Alliance for Rail Competition, p. 4; California PUC, p. 4; DuPont, p. 8.

³⁸ UP/SP Oversight, BNSF-PR-14, The Burlington Northern and Santa Fe Railway Company's Quarterly Progress Report, filed Jan. 18, 2000.

³⁹ See Ex Parte No. 634, Consolidated Railroad Reporting, Decision served Sept. 25, 2000.

KCS again exhibits a unique pursuit of private interest at the expense of public concerns. KCS wants the Board to treat it as a Class I railroad subject to the new merger rules only if it is the target of a hostile takeover. KCS, p. 6. Otherwise, it wants to be regarded as a Class II carrier. If KCS's proposal were adopted, KCS would be able to use the new merger rules as a shield against a hostile takeover by another railroad, protecting incumbent management by making the acquirer's task more onerous. The public has no interest in protecting incumbent KCS managers from an acquisition by another railroad. The public's interests in the impacts of a merger on competition and rail service are not affected by whether the transaction is consensual.

KCS should be treated as a Class I carrier, unless it can show by petition that a particular transaction does not have national significance. For example, a merger with a western carrier would raise substantial competitive issues, and UP would acknowledge that a UP/KCS merger would be a major transaction. A merger between KCS and an eastern carrier would substantially alter transcontinental and Northeast-Mexico traffic flows and would also be a major transaction. The Board should retain KCS's current classification as a Class I carrier.

The Board should consider an additional consequence of its classification rules. Under its proposed rules as now drafted, Class I merger applicants are required to provide special consideration to Class II and Class III railroads. Proposed § 1180.1(d) (requiring Class I applicants to enhance competition to strengthen and sustain Class II carriers). The Board should restrict this special consideration to Class III carriers. There is no reason to grant special concessions to regional railroads such as Wisconsin Central (to say nothing of KCS), which are potent competitors of the Class Is. Special treatment should be reserved for shortlines.


CONCLUSION

UP appreciates this opportunity to comment on the many views expressed in this proceeding. We hope our contributions prove constructive.

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December 18, 2000

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 18th day of December, 2000, a copy of the foregoing "Union Pacific's Reply Comments on Proposed Merger Rules" was served by regular mail, postage pre-paid, or a more expeditious manner of delivery on all parties and non-parties of record to this proceeding.


J. Michael Hemmer